

Report
of the
Examination of
Wausau Preferred Health Insurance Company
Wausau, Wisconsin
As of December 31, 1996

TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. HISTORY AND PLAN OF OPERATION	3
III. MANAGEMENT AND CONTROL	9
IV. AFFILIATED COMPANIES	14
V. REINSURANCE	22
VI. FINANCIAL DATA	24
VII. SUMMARY OF EXAMINATION RESULTS	35
VIII. CONCLUSION	40
IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS	42
X. ACKNOWLEDGMENT	43

March 19, 1998

Honorable Randy Blumer
Commissioner of Insurance
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

WAUSAU PREFERRED HEALTH INSURANCE COMPANY
Wausau, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1993 and 1994 as of December 31, 1992. The current examination covered the intervening period ending December 31, 1996, and included a review of such 1997 and 1998 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Financial Experience of the Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special

attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

A concurrent examination was conducted by the Market Regulation Bureau of Wisconsin's Office of the Commissioner of Insurance, and the results of that examination were expressed in a separate report. That report contains descriptions of company policies and procedures related to market conduct issues, as well as elaboration on those areas where adverse findings were noted.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the work papers of the independent public accounting firm. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

An independent actuary was engaged under a contract with the Office of the Commissioner of Insurance. He reviewed the adequacy of aggregate life and accident and health reserves, dividends to policyholders, cash-flow testing, deferred and uncollected premiums for life insurance, due and uncollected premiums for health insurance, and in-force testing. The results of his work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

II. HISTORY AND PLAN OF OPERATION

Wausau Preferred Health Insurance Company (hereinafter also “WPHIC” or the “company”), a stock life and health company operating under ch. 611, Wis. Stat., was incorporated on April 19, 1976, as Wausau Life Insurance Company. EMPLOYERS INSURANCE OF WAUSAU A Mutual Company, which was then known as Employers Mutual Liability Insurance Company (hereinafter also “Employers”), provided the initial capital and expendable surplus of the company.

In 1977, Wausau Service Corporation (hereinafter also “WSC”), a subsidiary of Employers, was restructured to act as a holding company for nearly all subsidiaries of Employers. Effective January 2, 1978, all outstanding stock of Employers' subsidiaries, including that of Wausau Life Insurance Company, was transferred to WSC.

On November 23, 1985, Employers consummated an affiliation agreement with Nationwide Mutual Insurance Company (hereinafter also “NMIC”) dated November 6, 1985. NMIC’s sister company, Nationwide Mutual Fire Insurance Company (hereinafter also “NMFIC”), is not party to the affiliation agreement. Within the context of this agreement, and certain subsequent agreements, NMIC exercises control of Employers and its subsidiaries through nomination of the various boards of directors, common executive management, and control of the reinsurance pool to which all direct premiums written by Employers are ceded and from which all net premiums written are assumed. The directors of Employers continue to be elected by the policyholders of Employers, as required by s. 611.53(2), Wis. Statutes. Election and reelection of nominees associated with NMIC on the Employers board have preserved the affiliation.

In January 1989, all outstanding stock of Wausau Life Insurance Company was transferred to Employers Life Insurance Company of Wausau.

On August 31, 1992, Wausau Life Insurance Company was renamed Wausau Preferred Health Insurance Company.

On December 31, 1992, at 11:59 p.m., WPHIC became the surviving entity in a merger with Preferred Health Insurance Company, a Wisconsin-domiciled life and health insurer

focused primarily on the sale of managed-care health products in the Milwaukee, Wisconsin metropolitan area. WPHIC had already reinsured all of Preferred Health Insurance Company's net insurance liabilities effective July 1, 1992. With the consent of the Office of the Commissioner of Insurance (OCI), this merger was not rendered effective for financial statement reporting purposes until January 1, 1993. This treatment was permitted in order to reflect the actual results of operations of the companies as separate entities throughout 1992. In all other respects, this merger was effective on December 31, 1992, at 11:59 p.m.

On December 31, 1994, Wausau Service Corporation sold all of the issued and outstanding shares of Employers Life Insurance Company of Wausau, the company's immediate parent, to Nationwide Life Insurance Company. The combined sales price of ELIC and WPHIC was \$155,000,000.

On January 1, 1997, ownership of Employers Life Insurance Company of Wausau was transferred to Nationwide Corporation, a holding company which common stock is owned by NMIC (95.2%) and NMFIC (4.8%). In this way, WPHIC became a third-tier subsidiary of Nationwide Mutual Insurance Company and Nationwide Mutual Fire Insurance Company, its current ultimate parents. Additional information concerning the holding company system headed by NMIC (hereinafter also "Nationwide Insurance Enterprise"), and the company's relationships with its affiliates, is contained in the section of this report titled, "Affiliated Companies".

Changes in the company's capitalization structure since incorporation are illustrated as follows:

Year	Number of Shares Authorized	Number of Shares Outstanding	Par Value per Share	Capital Paid Up	Gross Paid-In and Contributed Surplus
1976	1,000	150	-0-	\$10,000,000	\$ 5,000,000
1982	1,000	200	-0-	10,000,000	20,000,000
1988	1,000	200	-0-	10,000,000	30,000,000
1989	1,000	200	-0-	10,000,000	40,000,000
1991	1,000	200	-0-	10,000,000	60,000,000
1992	1,000	200	-0-	10,000,000	54,137,346
1993	1,000	200	-0-	10,000,000	60,137,346

The company has no employees of its own. All day-to-day operations are conducted with staff provided by Wausau Service Corporation and Nationwide Mutual Insurance Company in accordance with the business practices and internal controls of those organizations. Virtually all expenses are initially paid by EMPLOYERS INSURANCE OF WAUSAU A Mutual Company. Expenses other than federal income taxes are allocated in accordance with a system of approximately 1,000 allocation models, which, in turn, are developed on the basis of specific identification, utilization estimates, and time studies, in conformity with a general expense allocation agreement. The company's federal income taxes were filed on a separate, nonconsolidated basis in 1996. Intercompany balances with affiliates are created in the ordinary course of business with settlements generally made on a monthly basis. Written agreements with affiliates are further described in the section of this report titled, "Affiliated Companies".

WPHIC's operations are coordinated from the home offices of EMPLOYERS INSURANCE OF WAUSAU A Mutual Company in Wausau, Wisconsin. Support services are provided from a network of claim, legal, and marketing offices in the following cities throughout Wisconsin:

Appleton	Madison	Racine
Eau Claire	Milwaukee	Rice Lake
Fond du Lac	Onalaska	Sheboygan
Green Bay	Oshkosh	Wisconsin Rapids

In the state of Wisconsin, the company is licensed to transact participating and nonparticipating life and annuity business and disability lines of business as defined by s. Ins 6.75(1)(a) and (c), Wis. Adm. Code. The company is not licensed to conduct business in any other jurisdiction, nor are any license applications pending.

Until the merger with Preferred Health Insurance Company, the focus of WPHIC was on the assumption of life and accident and health insurance risks from affiliated insurers, and the administration of uninsured accident and health plans on behalf of Employers. With the merger, the company became a direct writer of group health plans, including both traditional indemnity and managed care products, but affiliated reinsurance continued as its most significant activity. The bulk of the company's reinsurance premiums were derived from group health business assumed from EMPLOYERS INSURANCE OF WAUSAU A Mutual Company, with the

remainder consisting of group life business assumed from its immediate parent. The administration of uninsured accident and health plans on behalf of Employers also continued to exert a more important influence on the company than the direct business. Most transactions associated with such plans are conducted through bank accounts owned by the various plan sponsors, and consequently most of the activity was not apparent on the annual statements of the company, except as net service income and expense.

A significant change in the company's operations began effective January 1, 1996, when all of the business written or reinsured by the company, including all outstanding loss and loss adjustment reserves, were ceded to Employers Life Insurance Company of Wausau. Employers Life took on WPHIC's former role as a reinsurer of affiliated life and accident and health insurance risks, and as the administrator of accident and health insurance plans for Employers. On a prospective basis, WPHIC is expected to concentrate its activities on providing commercial health insurance products issued in conjunction with other products sold by other companies in its holding company system.

The following tables form a comparative summary of gross and net premiums written, together with administrative service program results, in 1992 and 1996, respectively:

	1992 Premium	1992 Percent	1996 Premium	1996 Percent	Percent Change in Premium
Direct and Assumed Premium					
Group Life	\$10,628,808	5.4%	\$(3,614,360)	(26.5)%	N/A%
Group Health:					
Dental	7,390,208	3.7	3,180,195	23.3	(57.0)
Traditional Indemnity	109,325,529	55.1	65,665	0.5	(99.9)
Managed Care	71,085,881	35.8	14,048,084	102.9	(80.2)
Individual A&H (Non-Cancellable & Guaranteed Renewable)	<u>16,406</u>	<u>0.0</u>	<u>(6,283)</u>	<u>0.0</u>	<u>N/A</u>
Total All Lines	<u>\$198,446,832</u>	<u>100.0%</u>	<u>\$13,647,958</u>	<u>100.0%</u>	<u>100.0%</u>

Net Premium	1992 Premium	1992 Percent	1996 Premium	1996 Percent	Percent Change in Premium
Group Life	\$10,628,808	5.4%	\$(3,614,360)	(82.1)%	N/A%
Group Health:					
Dental	7,390,208	3.7	0	0.0	(100.0)
Traditional Indemnity	109,325,529	55.1	(757,053)	(17.2)	N/A
Managed Care	71,085,881	35.8	6	0.0	(100.0)
Individual A&H (Non-Cancellable)	16,406	0.0	(25,343)	(0.6)	N/A
Individual A&H (Guaranteed Renewable)	<u>0</u>	<u>0.0</u>	<u>(6,283)</u>	<u>(0.1)</u>	<u>N/A</u>
Total All Lines	<u>\$198,446,832</u>	<u>100.0%</u>	<u>\$(4,403,033)</u>	<u>(100.0)%</u>	<u>100.0%</u>
Uninsured A&H Plans	1992		1996		Percent Change in Results
Service income	\$19,312,862		\$-0-		(100.0)%
Service expense	<u>20,340,174</u>		<u>-0-</u>		(100.0)
Net return on service administration	<u>\$ (1,027,312)</u>		<u>\$-0-</u>		<u>(100.0)%</u>
Cash flow under management related to uninsured A&H programs	<u>\$360.8 million</u>		<u>\$-0-</u>		<u>(100)%</u>

Business is written through a sales force consisting of 313 agents, including both salaried WSC account representatives and independent agents paid on commission.

Account representatives are employees of the company. Each receives a salary, with the opportunity to earn a bonus, if his remuneration credits, tallied much the same as commissions, exceed his salary and chargeable business expenses. If remuneration credits do not exceed salary and chargeable expenses, there is no chargeback, nor is the deficiency carried into the following year's compensation formula.

Account representatives have access to the same employee benefit plans offered to nonmarketing employees. In addition, account representatives are eligible to participate in "The Capital Plan", a long-term deferred compensation program specifically for marketing employees. Under this plan, a percentage of the revenue produced by the account representative

above a set threshold of annual production is set aside on his behalf, and earns investment income. After 10 full years of service, if the representative does not violate his marketing agreement and is not discharged for embezzlement, misappropriation of funds, fraud, or other valid cause, the deferred compensation and earnings thereon are vested with the representative.

Independent agents are compensated according to the following commission schedule. All rates are on a sliding scale that declines with the volume of premium or service revenue related to a specific policy:

Product Line	Commission Rates
Group Accident & Health - Insured	0.5% to 4.0%
Group Accident & Health - ASO	6% for first \$200,000 only
Group Dental - Insured	1.4% to 8.1%
Group Dental -ASO	0.6% to 15.5%

III. MANAGEMENT AND CONTROL

Control by Succession of Parent Corporations

Nationwide Mutual Insurance Company holds ultimate control of the company's board and of its executive direction. As more thoroughly described both previously and in Section IV, "Affiliated Companies", of this report, all issued and outstanding common shares of the company are indirectly, but wholly, owned by Nationwide Mutual Insurance Company and Nationwide Mutual Fire Insurance Company. While a director of the company is generally elected for a term of one year, the Articles of Incorporation provide that a director may be removed from office by an affirmative majority vote taken at any annual or special meeting of the sole shareholder.

In addition to control of its board of directors, ultimate executive direction of the company is held by the chief executive officer of Nationwide Mutual Insurance Company. Article V, Section 6, of the bylaws, states that, "The Chairman and Chief Executive Officer - Nationwide Insurance Enterprise shall be the chief executive officer and shall exercise general administrative leadership and direction of the Corporation in conformity with the actions and controls established and maintained by the Board of Directors".

Board of Directors

The board of directors consists of five members. Directors are elected annually to serve one-year terms. As executive employees of the holding company system, the directors receive no compensation specific to their service on the board. Members of the company's board of directors are typically members of other boards of directors in the holding company system. Officers are elected at the board's annual organizational meeting, and as positions are created or fall vacant.

At the examination date, the board of directors consisted of the following

persons:

Name and Residence	Principal Occupation	Expiry
Galen R. Barnes Columbus, Ohio	Vice Chairman of the Board Nationwide Mutual Insurance Company	1998
Dwight E. Davis Mosinee, Wisconsin	President and Chief Operating Officer EMPLOYERS INSURANCE OF WAUSAU A Mutual Company	1998
Alfred P. Moore Wausau, Wisconsin	Senior Vice President, Group Operations EMPLOYERS INSURANCE OF WAUSAU A Mutual Company	1998
Dimon R. McFerson Delaware, Ohio	Chairman and Chief Executive Officer - Nationwide Insurance Enterprise, Nationwide Mutual Insurance Company	1998
Douglas C. Robinette Wausau, Wisconsin	Executive Vice President, Customer Services EMPLOYERS INSURANCE OF WAUSAU A Mutual Company	1998

Committees of the Board

Article IV of the company's bylaws permit the formation of committees by the board of directors. There are currently no board committees. However, on May 26, 1995, the board recognized and authorized the joint investment committee of Nationwide Mutual Insurance Company and EMPLOYERS INSURANCE OF WAUSAU A Mutual Company "to review and approve investments, to issue executive resolutions, and to otherwise act on behalf of the Corporation in investment decisions, consistent with applicable laws and regulations and existing contractual and other obligations of the Corporation."

This investment committee is a joint committee resolving upon matters affecting Employers, Wausau Business Insurance Company, Wausau Underwriters Insurance Company, Employers Life Insurance Company of Wausau, and Wausau Preferred Health Insurance Company. The primary function of this committee is to recommend to the full board a general investment policy for the company. It also reviews, monitors, and approves the investment transactions authorized by management between its meetings. The investment committee meets more frequently than most of the other board committees, usually seven or eight times

per year. Most of the deliberations and discussions of the committee members occur out of session. During its meetings, the committee enters documents and plans, and the results of its deliberations upon those documents and plans into the minutes. Membership of the investment committee at the examination date was as follows: D. Richard McFerson (Chairperson), Charles L. Fuellgraf, Jr., Henry S. Holloway, David O. Miller, James F. Patterson, and Arden L. Shisler.

It is the practice of the board to review and ratify the decisions of this joint investment committee.

Other Joint Committees

Due to significant overlap in the membership of the boards of Nationwide Mutual Insurance Company and its insurance company subsidiaries and affiliates and the boards of Employers and its insurance subsidiaries and affiliates, committee meetings are often conducted on a joint basis on behalf of the entire Nationwide Insurance Enterprise. The following joint committees of Nationwide Mutual Insurance Company and EMPLOYERS INSURANCE OF WAUSAU A Mutual Company deliberate and resolve upon matters affecting the company, though they have not been formally recognized by WPHIC's board.

Audit Committee

The joint audit committee meets from time to time as necessary, typically four or five times per year. It is the function of this committee to maintain direct lines of communication between the board and both the company's independent public accounting firm, and its internal audit department. The committee makes recommendations to the full board on the appointment of public accountants; reviews the financial statements of entities within the Nationwide Insurance Enterprise; inquires into the effectiveness of the company's internal auditing methods and procedures; and makes reports concerning its activities to the full board. Membership of the audit committee at the examination date was as follows: James F. Patterson (Chairman), Lewis J. Alphin, Willard J. Engel, C. Ray Noecker, San W. Orr, Jr., and Robert L. Stewart.

Salary and Compensation Committee

The salary and compensation committee meets from time to time as its responsibilities may require; during the examination period, it has usually met six or seven times

per year. It is the function of this committee to research and issue recommendations to the board as a whole concerning director and senior executive compensation. Oversight is also extended to matters affecting retirement programs and employee benefit plans, succession plans, and personnel matters relating to high-level executives. Membership of the salary and compensation committee at the examination date was as follows: David O. Miller (Chairman), Fred C. Finney, Charles L. Fuellgraf, Jr., Willard J. Engel, Henry S. Holloway, D. Richard McFerson, and Nancy C. Thomas.

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are listed below.

Name	Office
D. Richard McFerson	Chairman of the Board
D. Richard McFerson	Chairman & Chief Executive Officer - Nationwide Insurance Enterprise
Galen R. Barnes	President
Alfred P. Moore	Executive Vice President and Chief Operating Officer
Gordon E. McCutchan	Executive Vice President, Law and Corporate Services and Secretary
Robert A. Oakley	Executive Vice President & Chief Financial Officer
Robert J. Woodward, Jr.	Executive Vice President & Chief Investment Officer
W. Sidney Druen	Senior Vice President, General Counsel, and Assistant Secretary
Douglas C. Robinette	Executive Vice President, Customer Services
Jay M. Anliker	Vice President - Financial Services and Assistant Secretary
E. Jay Coldwell	Vice President - Managed Care ¹
Thomas J. Erickson	Vice President - Group Retirement
Alan N. Ferguson	Vice President
J. Stanley Hoffert	Vice President - Associate General Counsel and Secretary
John R. Laehn	Vice President - HMO Operations
Michael D. Lawless	Vice President - Structured Settlements and Individual Insurance
Thomas K. Manion	Vice President & Controller
Edwin P. McCausland, Jr.	Vice President - Fixed Income Securities
Robert H. McNaughten	Vice President - Investments
Gerald E. Osband, M.D.	Vice President - Medical Affairs and Managed Care Development
John G. Powles	Vice President

Name	Office
Joseph San Filippo	Vice President - Group Claim Administration
Mark E. Saxton	Vice President - Standard Accounts
Stephen A. Sedlak	Vice President - Chief Actuary
Jeffrey L. Zriny	Vice President - Employee Benefits Marketing
John S. Torrens	Vice President & Treasurer

IV. AFFILIATED COMPANIES

Wausau Preferred Health Insurance Company is a member of the Nationwide Insurance Enterprise, a multinational holding company system under the dual control of Nationwide Mutual Insurance Company (NMIC) and Nationwide Mutual Fire Insurance Company (NMFIC). A chart of the companies within the holding company system is presented later in this section of the examination report.

Present Succession of Control

WPHIC is a third-tier affiliate of NMIC. Each entity in the immediate succession of control is described below, beginning with the ultimate parent and progressing to the next immediate tier of control.

Nationwide Mutual Insurance Company

Nationwide Mutual Insurance Company was incorporated under the laws of the state of Ohio on December 16, 1925, and commenced business on April 14, 1926. It was organized under the auspices of, and endorsed by, the Ohio Farm Bureau Federation to provide automobile insurance to those eligible for membership in the federation. Operations were conducted under the name of Farm Bureau Mutual Automobile Insurance Company until September 1, 1955, when the present name was adopted. It retains strong ties to its agribusiness origins through a distinctive process of nominating its independent (non-employee) directors. Eleven of the 14 members of the board are nominated from certain sponsorship organizations, specifically, the Ohio Farm Bureau Federation, Maryland Farm Bureau, Ruralite Services, Farmland Industries, Pennsylvania Farmers' Association, and Southern States Cooperative. After a nominee of a sponsorship organization is elected to the board by a majority vote of the policyholders, the newly elected director resigns from any office held with the sponsorship organization.

As of December 31, 1996, NMIC, and its sister company, NMFIC, exercised direct or indirect ownership or control of 111 legal entities, including 98 stock corporations, 3 mutual insurance companies, 4 common law trusts, 2 not-for-profit corporations, 2 limited partnerships, and 2 limited liability companies. The primary focus of the Nationwide holding company system is the underwriting and distribution of insurance products and services, with 23 property and

casualty insurers, 6 life and health insurers, 5 health maintenance organizations, 35 insurance brokerages and agencies, and 10 providers of ancillary insurance-related services. The other 34 entities conduct a diversified range of activities, including mutual fund investment services, real estate investment and management, radio and television broadcasting, data processing, and administration of deferred compensation programs for state and municipal civil service employees throughout the country. The holding company system is a significant provider of variable annuity contracts to members of the National Educational Association.

NMIC's current business emphasis remains with automobile coverages, with distribution primarily by independent agents who confine their representation exclusively to companies in the Nationwide Insurance Enterprise. The company is licensed in the District of Columbia, Puerto Rico, the Virgin Islands, and all states except New Jersey. Approximately 51% of the company's direct premium is written in Pennsylvania, New York, North Carolina, and Ohio. Headquarters are maintained in Columbus, Ohio. As of December 31, 1996, NMIC reported assets of \$13,771,824,796, liabilities of \$9,134,962,193, policyholders' surplus of \$4,636,862,603, and net income of 153,020,690. NMIC was examined concurrently with Employers Insurance of Wausau A Mutual Company as of December 31, 1996, and the results of that examination were expressed in a separate report issued by the Ohio Department of Insurance.

Nationwide Mutual Fire Insurance Company

Nationwide Mutual Fire Insurance Company was incorporated under the laws of the state of Ohio on December 27, 1933, and commenced business on April 15, 1934. The incorporator was Nationwide Mutual Insurance Company, then known as the Farm Bureau Mutual Automobile Insurance Company, which advanced all of the organizational expense and initial financing. Operations were conducted under the name of Farm Bureau Mutual Fire Insurance Company until September 1, 1955, when the present name was adopted. Its board of directors is selected under the same nomination process as its sister company, Nationwide Mutual Insurance Company. Although elected in a separate ballot by NMFIC policyholders, the boards of NMIC and NMFIC have long been composed of the same persons.

NMFIC's current business emphasis is on personal home and automobile lines, with distribution primarily by independent agents who confine their representation exclusively to companies in the Nationwide Insurance Enterprise. The company is licensed in all 50 U.S. states, the District of Columbia, Puerto Rico, and the Virgin Islands. Approximately 57% of the company's direct premium is written in Florida, Ohio, North Carolina, and Pennsylvania. Headquarters are maintained in Columbus, Ohio. As of December 31, 1996, NMFIC reported assets of \$2,346,229,168, liabilities of \$1,623,282,638, policyholders' surplus of \$722,946,530, and net income of \$28,378,567. NMFIC was examined concurrently with EMPLOYERS INSURANCE OF WAUSAU A Mutual Company as of December 31, 1996, and the results of that examination were expressed in a separate report issued by the Ohio Department of Insurance.

Nationwide Corporation

Nationwide Corporation is an Ohio-domiciled holding company incorporated on January 25, 1947. Nationwide Mutual Insurance Company, with ownership of 95.2% of all outstanding common shares, exercises effective control of the corporation. Nationwide Mutual Fire Insurance Company holds all other common shares. As of December 31, 1996, the corporation's consolidated financial statements reported assets of \$50,254,030,000, liabilities of \$47,624,734,000, policyholders' surplus of \$2,629,269,000, and net income of \$217,568,000.

Employers Life Insurance Company of Wausau

Employers Life Insurance Company of Wausau, a Wisconsin-domiciled life and health insurer, was incorporated on August 23, 1965, and commenced business on September 1, 1965. Effective January 1, 1996, Employers Life took on WPHIC's former role as a reinsurer of affiliated life and accident and health insurance plans for EMPLOYERS INSURANCE OF WAUSAU A Mutual Company. Previously, the company's focus had gradually narrowed to writing structured settlement annuities on behalf of its P&C affiliates in the Nationwide Insurance Enterprise and administering contract deposits for employee benefit plans, though the latter business has been restricted to existing customers for some years. While a closed book of individual life, disability, and annuity business is reflected in the annual statement, West Coast Life Insurance Company has fully reinsured and administered the run off since 1994 under a

package of modified coinsurance treaties and administrative agreements. The company is a wholly owned subsidiary of Nationwide Corporation. It, in turn, owns 100% of WPHIC and 80% of Key Health Plans, Inc. The company's 1996 statutory annual statement indicates assets of \$1,336,025,972, liabilities of \$1,209,516,492, policyholders' surplus of \$126,509,480, and a net loss of \$16,048,372. Both assets and liabilities reflect separate accounts aggregating to \$207,950,415.

Other Affiliates Not in the Succession of Ownership

EMPLOYERS INSURANCE OF WAUSAU A Mutual Company

EMPLOYERS INSURANCE OF WAUSAU A Mutual Company (Employers), is a Wisconsin-domiciled insurer that leads a distinct holding company subsystem within the Nationwide holding company system, commonly known as the Wausau Insurance Companies. Employers exercises direct or indirect ownership and control over 26 entities, including 5 property and casualty insurers, 3 health maintenance organizations, 12 insurance brokerages or agencies, 4 providers of ancillary insurance services, a radio station, and a holding company. The insurer writes property and casualty lines of business, with an emphasis on large and medium-sized business clients. The insurer's 1996 statutory annual statement indicates assets of \$3,096,811,348, liabilities of \$2,602,053,667, policyholders' surplus of \$494,757,681, and a net income of \$21,639,737. Employers was examined concurrently with WPHIC as of December 31, 1996, and the results of that examination were expressed in a separate report.

Employers entered into an affiliation agreement with NMIC on November 6, 1985. NMIC's sister company, NMFIC, is not party to the affiliation agreement. Within the context of this agreement, and certain subsequent agreements, NMIC exercises control of Employers Mutual and its subsidiaries through nomination of the various boards of directors, common executive management, and control of the reinsurance pool to which all premiums written by Employers are ceded and from which all net premiums written are assumed. The directors of Employers Mutual continue to be elected by the policyholders of Employers Mutual, as required by s. 611.53(2), Wis. Statutes.

Wausau Service Corporation

Wausau Service Corporation was incorporated under the laws of the state of Wisconsin as the “Wausau Insurance Finance Corporation” on September 21, 1959. It was initially organized to finance insurance premiums, a function that had been handled through the Insurance Finance Company, an independently owned corporation. Within only a few years, with the introduction of company installment plans, the corporation's original purpose became largely obsolete. From 1964 to the formation of Countrywide Services Corporation in 1971, WSC provided loss adjustment, safety, and health services to self-insured accounts on behalf of the Wausau Insurance Companies. Thereafter, for a time, the corporation essentially fell dormant. Then, in late 1977, it was decided to reactivate WSC as a downstream holding company. On November 18, 1977, WSC's board of directors voted to accept transfer of ownership from EMPLOYERS INSURANCE OF WAUSAU A Mutual Company (then known as Employers Mutual Liability Insurance Company of Wisconsin) the capital stock of all affiliates except Wausau Insurance Company (U.K.) Limited (then known as Employers of Wausau (U.K.) Ltd.) effective January 2, 1978. As of December 31, 1996, the corporation reported assets of \$191,832,000, liabilities of \$6,562,000, stockholders equity of \$185,270,000, and a net loss of \$3,299,000.

Written Agreements with Affiliates

As previously noted, WPHIC has no employees of its own. All operations are conducted by employees of WSC and NMIC, in accordance with the business practices and internal controls of those organizations. In addition to ongoing common management and control by these upstream affiliates, the company's relationship to its affiliates is affected by various written agreements. Reinsurance agreements are described in the reinsurance section of this report. A brief summary of the other agreements follows:

1. Effective January 1, 1991, the company entered into a service agreement whereby WSC agrees to provide various services including, but not limited to, sales, technical, administrative, and support functions. Expenses subject to this agreement are to be accounted for in accordance with the standards established by the National Association of Insurance Commissioners (NAIC).

2. WPHIC entered into an expense allocation agreement with Employers and its other affiliates. These companies share various administrative services, office facilities, and equipment, with expenses being apportioned among the applicable member/user companies.
3. The company entered into an investment agency agreement with Nationwide Cash Management Company effective April 14, 1986. The business of Nationwide Cash Management Company consists of investing and reinvesting funds contributed by Nationwide Mutual Insurance Company and its affiliates in short-term debt instruments with a maximum duration of one year. It functions in a manner analogous to a short-term bond mutual fund. This agreement may be terminated at the end of any business day upon written notice of WPHIC or upon 30 days' written notice from Nationwide Cash Management Company.
4. The company entered into an investment agency agreement with California Cash Management Company effective May 19, 1989. The business of California Cash Management Company is identical to that of its affiliate, Nationwide Cash Management Company. The purpose and structure of this agreement are identical to that with Nationwide Cash Management Company.

HOLDING COMPANY CHART

FIRST PAGE OF TWO

HOLDING COMPANY CHART

SECOND PAGE OF TWO

V. REINSURANCE

The company's major reinsurance treaties in force at the time of the examination are summarized below. The contracts contained proper insolvency provisions.

Affiliated Ceding Contracts

Type:	Automatic Coinsurance Agreement
Reinsurer:	Employers Life Insurance Company of Wausau
Scope:	All group health and life business written or assumed by the reinsured.
Retention:	None
Coverage:	100% of the net results of the group business
Premium:	(1) Portfolio transfer of all net reserves of the reinsured as of December 31, 1995. (2) 100% of the net premium less commissions, taxes, and other expenses.
Commissions:	\$34,751,143 for EMPLOYERS INSURANCE OF WAUSAU A Mutual Company, and \$2,391,838 for Wausau Preferred Health Insurance Company, based on the accounting results and settlement for period ended December 31, 1996.
Effective date:	January 1, 1996, continuous
Termination:	Upon 30 day prior written notice by either party. Any termination shall be on a run-off basis.

Nonaffiliated Ceding Contracts

Type:	Life Excess Catastrophe Contract												
Reinsurer:	ReliaStar Life Insurance Company												
Scope:	In force, new and renewal Group Life and Group Accident Death & Disability (AD&D) insurance.												
Retention:	Determined as of January 1 of each calendar year. Retention was 90.4% in 1996.												
Coverage:	<p>\$40,000,000 in excess of \$1,000,000 of ultimate net loss per occurrence, subject to a three life warranty. The Company is deemed to have reinsurance to limit subject losses to the following per person:</p> <table><tr><td>(1)</td><td>Group Life</td><td>\$200,000</td></tr><tr><td>(2)</td><td>Wausau Insurance Companies' Employee Group Life</td><td>0*</td></tr><tr><td>(3)</td><td>Pre-Retirement Death Benefit</td><td>0*</td></tr><tr><td>(4)</td><td>Group AD&D</td><td>150,000</td></tr></table>	(1)	Group Life	\$200,000	(2)	Wausau Insurance Companies' Employee Group Life	0*	(3)	Pre-Retirement Death Benefit	0*	(4)	Group AD&D	150,000
(1)	Group Life	\$200,000											
(2)	Wausau Insurance Companies' Employee Group Life	0*											
(3)	Pre-Retirement Death Benefit	0*											
(4)	Group AD&D	150,000											

(5)	Wausau Insurance Companies' Employee Group AD&D	0*
(6)	Combination Group Life and Group AD&D	350,000
(7)	Wausau Insurance Companies' Employee Combination Group Life, Pre-Retirement Death Benefit and Group AD&D	0*

* As of January 1, 1996, the Wausau Insurance Companies' group insurance plans were transferred to Nationwide Mutual Insurance Company.

Premium: \$7,100 annual minimum premium payable in quarterly installments. Annual adjustment based on the rate of \$2.75 per million of mean net retained liability in force during the contract year.

Effective date: Continuous from January 1, 1995.

Termination: At any December 31 with 90 days prior notice by certified mail.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 1996, annual statement to the Commissioner of Insurance.

Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Policyholders' Surplus per Examination". Also included in this section are schedules which reflect the financial experience of the company, the compulsory and security surplus calculation, and NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination.

Wausau Preferred Health Insurance Company
Assets
As of December 31, 1996

	Ledger Assets	Nonledger Assets	Nonadmitted Assets	Admitted Assets
Bonds	\$88,562,137	\$	\$	\$88,562,137
Cash	67,015			67,015
Short-term investments	5,113,721			5,113,721
Federal income tax recoverable		92,000		92,000
Accident and health premiums due and unpaid		300,719		300,719
Investment income due and accrued		1,143,390		1,143,390
Receivable from parent, subsidiaries, and affiliates	51,407			51,407
Write-ins for non-invested assets:				
Accounts receivable	2,684			2,684
Miscellaneous receivable for securities	<u>519</u>	<u> </u>	<u> </u>	<u>519</u>
Total Assets	<u>\$93,797,483</u>	<u>\$1,536,109</u>	<u>\$ -0-</u>	<u>\$95,333,592</u>

Liabilities, Surplus, and Other Funds
As of December 31, 1996

Policy and contract liabilities not included elsewhere:	
Interest maintenance reserve	\$ 5,796
Taxes, licenses, and fees due or accrued, excluding federal income taxes	232,020
Miscellaneous liabilities:	
Asset valuation reserve	1,025,698
Payable to parent, subsidiaries, and affiliates	500,059
Total Liabilities	1,763,573
Common capital stock	10,000,000
Gross paid in and contributed surplus	62,238,883
Unassigned funds (surplus)	<u>21,331,136</u>
Total Capital and Surplus Items	<u>93,570,019</u>
Total Liabilities, Surplus, and Other Funds	<u>\$95,333,592</u>

Wausau Preferred Health Insurance Company
Summary of Operations
For the Year 1996

Premiums and annuity considerations	\$(4,403,033)
Net investment income	6,496,338
Amortization of interest maintenance reserve	(6,015)
Commissions and expense allowances on reinsurance ceded	<u>2,391,838</u>
Total income items	4,479,128
Death benefits	4,043,917
Disability benefits and benefits under accident and health policies	15,078,539
Increase in aggregate reserve for life and accident and health policies and contracts	(19,911,129)
Increase in liability for premium and other deposit funds	<u>(3,614,360)</u>
Subtotal	(4,403,033)
Commissions on premiums and annuity considerations	868
General insurance expenses	2,227,403
Insurance taxes, licenses, and fees, excluding federal income taxes	<u>617,567</u>
Total deductions	<u>(1,557,195)</u>
Net gain from operations before dividends to policyholders and federal income taxes	6,036,323
Net gain from operations after dividends to policyholders and before federal income taxes	6,036,323
Federal income taxes	<u>1,319,305</u>
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses)	4,717,018
Net realized capital gains or losses	<u>6,755</u>
Net Income	<u>\$4,723,773</u>

Wausau Preferred Health Insurance Company
Cash Flow
As of December 31, 1996

Premiums and annuity considerations	\$(4,492,299)	
Net investment income	6,814,831	
Commissions and expense allowances on reinsurance ceded	2,391,838	
Write-ins for miscellaneous income: Service contract fees	<u>(693,555)</u>	
Total		\$4,020,815
Death benefits	6,012,550	
Disability, accident and health benefits	43,047,333	
Subtotal	49,059,883	
Commissions on premium and annuity considerations	868	
General insurance expenses	2,227,403	
Insurance taxes, licenses and fees, excluding federal income taxes	373,567	
Total deductions before dividends and federal income taxes	51,661,721	
Federal income taxes	<u>911,305</u>	
Total deductions		<u>52,573,026</u>
Net cash from operations		\$(48,552,211)
Proceeds from investments sold, matured, or repaid: Bonds	<u>34,118,108</u>	
Total investment proceeds	34,118,108	
Less: Net tax on capital gains (losses)	(21,305)	
Total investment proceeds	34,139,413	
Cost of investments acquired (long-term only): Bonds	<u>10,016,922</u>	
Total investments acquired	10,016,922	
Net cash from investments		24,122,491
Cash provided from financing and miscellaneous sources: Other sources	<u>33,963,900</u>	
Cash applied for financing and miscellaneous uses: Other applications	<u>4,870,108</u>	
Net cash from financing and miscellaneous sources		<u>29,093,792</u>
Net change in cash and short-term investments		4,664,072
Reconciliation		
Cash and short-term investments, January 1, 1996		<u>516,664</u>
Cash and short-term investments, December 31, 1996		<u>\$5,180,736</u>

**Wausau Preferred Health Insurance Company
Compulsory and Security Surplus Calculation
December 31, 1996**

Assets		\$95,333,592	
Less liabilities		<u>1,763,573</u>	
Adjusted surplus			\$93,570,019
Annual premium:			
Individual life and health	(31,626)		
Factor	<u>15%</u>		
Total		\$(4,744)	
Group life and health	(4,460,673)		
Factor	<u>10%</u>		
Total		<u>(446,067)</u>	
Compulsory surplus (subject to a \$2,000,000 minimum)			<u>2,000,000</u>
Compulsory surplus excess or (deficit)			<u>\$91,570,019</u>
Adjusted surplus			\$93,570,019
Security surplus:			
(140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million with a minimum of 110%)			<u>2,800,000</u>
Security surplus excess or (deficit)			<u>\$90,770,019</u>

**Wausau Preferred Health Insurance Company
Reconciliation and Analysis of Policyholders' Surplus
For the Four-Year Period Ending December 31, 1996**

The following schedule is a reconciliation of total policyholders' surplus during the period under examination as reported by the company in its filed annual statements:

Policyholders' surplus, December 31, 1992	\$66,238,883
---	--------------

1993

Net income	\$6,940,688
Change in asset valuation reserve	(134,113)
Surplus adjustments:	
Paid in	<u>6,000,000</u>

Net change in policyholders' surplus for the year	<u>12,806,575</u>
---	-------------------

Policyholders' surplus, December 31, 1993	79,045,458
---	------------

1994

Net income	\$9,694,001
Change in nonadmitted assets and related items	(7,931)
Change in asset valuation reserve	<u>(330,012)</u>

Net change in policyholders' surplus for the year	<u>9,356,058</u>
---	------------------

Policyholders' surplus, December 31, 1994	88,401,516
---	------------

1995

Net income	\$471,650
Change in nonadmitted assets and related items	4,241
Change in asset valuation reserve	<u>(118,176)</u>

Net change in policyholders' surplus for the year	<u>357,715</u>
---	----------------

Policyholders' surplus, December 31, 1995	88,759,231
---	------------

1996

Net income	\$4,723,773
Change in nonadmitted assets and related items	5,450
Change in asset valuation reserve	<u>81,565</u>

Net change in policyholders' surplus for the year	<u>4,810,788</u>
---	------------------

Policyholders' surplus, December 31, 1996	<u>\$93,570,019</u>
---	---------------------

**Wausau Preferred Health Insurance Company
Insurance Regulatory Information System
For the Four-Year Period Ending December 31, 1996**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

Ratio No. 1—Net Change in Capital and Surplus

NAIC exceptional results are any values less than or equal to -10% or greater than or equal to 50%

Company Results -	1993	14%
	1994	12
	1995	0
	1996	5

Ratio No. 1A—Gross Change in Capital and Surplus

NAIC exceptional results are any values less than or equal to -10% or greater than or equal to 50%

Company Results -	1993	23%
	1994	12
	1995	0
	1996	5

Ratio No. 2—Net Gain to Total Income

NAIC exceptional results are any values less than or equal to 0

Company Results -	1993	4%
	1994	5
	1995	0*
	1996	105

Ratio No. 3 has been discontinued.

Ratio No. 4—Adequacy of Investment Income

NAIC exceptional results are any values greater than or equal to 900% or less than or equal to 125% (not calculated for 1995)

Company Results -	1993	999%*
	1994	878
	1996	999*

Ratio No. 5—Nonadmitted to Admitted Assets

NAIC exceptional results are any values greater than or equal to 10%

Company Results -	1993	0%
	1994	0
	1995	0
	1996	0

Ratio No. 6—Total Real Estate and Mortgage Loans to Cash and Invested Assets

NAIC exceptional results are any values greater than or equal to 30%

Company Results -	1993	0%
	1994	0
	1995	0
	1996	0

Ratio No. 7—Affiliates to Capital and Surplus

NAIC exceptional results are any values greater than or equal to 100%

Company Results -	1993	4%
	1994	1
	1995	0
	1996	0

Ratio No. 8—Surplus Relief

NAIC exceptional results are any values less than or equal to -99% or greater than or equal to 30% for companies with \$5 million or more in capital and surplus; NAIC exceptional results are any values less than or equal to -10% or greater than or equal to 10% for companies with less than \$5 million in capital and surplus

Company Results -	1993	(43)%
	1994	(40)
	1995	(40)
	1996	3

Ratio No. 9—Change in Premium

NAIC exceptional results are any values less than or equal to -10% or greater than or equal to 50%

Company Results -	1993	(5)%
	1994	(5)
	1995	(4)
	1996	(99)*

Ratio No. 10—Change in Product Mix

NAIC exceptional results are any values greater than or equal to 5%

Company Results -	1993	0.1%
	1994	0.2
	1995	0.2
	1996	NR*

Ratio No. 11—Change in Asset Mix

NAIC exceptional results are any values greater than or equal to 5%

Company Results -	1993	1.3%
	1994	0.4
	1995	0.6
	1996	1.0

Ratio No. 12—Change in Reserving Ratio

NAIC exceptional results are any values less than or equal to -20% or greater than or equal to 20%

Company Results -	1993	0%
	1994	0
	1995	0
	1996	0

During the period under examination, there were five exceptional ratios. The reasons for these exceptions varied over time. It has been typical for the “Adequacy of Investment Income” to be relatively high because the company uses low tabular interest amounts for its contracts, in comparison to those being achieved on the investment portfolio. While Ratio #4 resulted in an exceptional value in 1993, the result is generally consistent with the company’s historical pattern.

In 1995, the unusual result for Ratio #2, "Net Gain to Total Income", was explained by adverse operating results in the group A&H business assumed from affiliates. The trend factor in health care costs increased faster than anticipated in 1995. The company also claimed that it was not able to obtain desired rate increases on policy renewals.

The unusual results for Ratio #4, "Adequacy of Investment Income", Ratio #9, "Change in Premium", and Ratio #10, "Change in Product Mix", can all be traced to the significant change in the company's plan of operation previously described. As of January 1, 1996, all of the business written or reinsured by the company, including all outstanding loss and loss adjustment reserves, was ceded to Employers Life Insurance Company of Wausau. Employers Life took on WPHIC's former role as a reinsurer of affiliated life and accident and health insurance risks, and as the administrator of accident and health insurance plans for Employers.

Financial Experience of Wausau Preferred Health Insurance Company

Year	Admitted Assets	Liabilities	Policyholders' Surplus
1992	\$136,810,471	\$70,571,588	\$66,238,883
1993	141,160,762	62,115,304	79,045,458
1994	148,457,806	60,056,290	88,401,516
1995	149,389,386	60,630,155	88,759,231
1996	95,333,592	1,763,573	93,570,019

Life Insurance In Force (in thousands)

Year	Gross Direct and Assumed	Ceded	Net
1992	\$1,762,029	\$353,331	\$1,408,698
1993	2,031,632	269,005	1,762,627
1994	2,151,953	278,997	1,872,956
1995	1,957,121	312,937	1,644,184
1996	1,644,184	(1,644,184)	0

Accident and Health

Year	Direct Premium Written	Net Premiums Earned	Net Losses Incurred	Commissions Incurred	Combined Other Expenses Incurred	Loss and Expense Ratio
1992	\$ 0	\$187,754,980	\$155,051,312	\$31,651,274	\$1,291,509	100.1%
1993	9,864,113	176,787,197	142,301,277	31,336,343	2,124,796	99.4
1994	10,052,517	165,951,525	128,177,261	32,388,453	27,472,867	113.3
1995	11,653,340	163,430,313	140,846,897	32,568,331	32,020,247	125.7
1996	18,050,991	(115,389)	0	(2,390,970)	2,275,581	N/A

The foregoing charts, summarizing the company's financial experience in recent years, correctly suggest that the company underwent a major change in its plan of operation during 1996. Effective January 1, 1996, the company ceded all business written or reinsured, including all outstanding loss or loss adjustment expense reserves, to its immediate parent, Employers Life Insurance Company of Wausau. Employers Life took on WPHIC's former role as a reinsurer of affiliated life and accident and health risks, and as the administrator of accident and health insurance plans for EMPLOYERS INSURANCE OF WAUSAU A Mutual Company.

Accordingly, life insurance in force dropped to nothing. Figures for premium written, net premiums earned, net losses incurred, and commissions incurred are also consistent with the change in the company's business plan.

There was a notable decline in assets during 1996. This, too, is a result of the changes to the affiliated reinsurance contracts effective January 1, 1996. To support the transfer of reserves on that date, WPHIC conveyed \$49,470,049 in assets to Employers Life, consisting of bonds with a statement value of \$20,374,188 and \$29,095,861 in funds held on deposit with EMPLOYERS INSURANCE OF WAUSAU A Mutual Company.

Reconciliation of Policyholders' Surplus per Examination

The company reported \$93,570,019 in policyholders' surplus as of December 31, 1996. The examination resulted in no adjustments or reclassifications to this reported figure.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were eight specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Management and Control - Therefore, it is recommended that the company's board of directors formally recognize the advisory role of this joint investment committee if it is to continue to rely upon the advice of this committee. A standing resolution appointing Employers' investment committee as an ex-officio advisory committee to the board is one of the possible methods of recognition. The action taken should conform to the articles of incorporation and bylaws of the company.

Action - Compliance.

2. Corporate Records - It is again recommended that the company adopt a service agreement with the Nationwide Companies for the servicing of its business.

Action - Noncompliance. Further comment is contained in the section of this report captioned, "Corporate Records".

3. Corporate Records - It is recommended that the company place the terms of its arrangement with Employers for the servicing of uninsured accident and health plans in the form of a written contract.

Action - No longer applicable.

4. Corporate Records - It is recommended that the company develop a procedure whereby a glossary of corporate contracts and reinsurance treaties is maintained pursuant to s. 601.42, Wis. Stat.

Action - Compliance.

5. Short-term Investments - It is recommended that the company report the gross amount of interest received on short-term investments in accordance with the format of the convention annual statement.

Action - Company personnel complied with this recommendation as they understood it. Further comment is contained in the section of this report captioned "Short-term Investments."

6. Unlisted Assets - It is recommended that the company utilize Schedule X in accordance with the NAIC's Annual Statement Instructions - Life and Health.

Action - Compliance.

7. Income and Expense Related to Uninsured Accident and Health Plans - It is recommended that, in future statutory annual statements, the company report expenses associated with its uninsured accident and health plans in sufficient detail as to indicate the nature of the expenses with reasonable precision in accordance with the NAIC's Annual Statement Instructions - Life and Health.

Action - No longer applicable.

8. Gross Paid-in and Contributed Surplus - Unassigned Surplus Funds - It is recommended that no restructure of the capital and surplus accounts be effected or reported without the specific authorization of the board and approval by the shareholders.

Action - Compliance.

Summary of Current Examination Results

Management and Control

The compliance examination as of December 31, 1992, noted that a joint investment committee comprising members of the boards of Nationwide Mutual Insurance Company and EMPLOYERS INSURANCE OF WAUSAU A Mutual Company, though not elected or otherwise recognized by WPHIC's board, had issued signed executive resolutions on behalf of WPHIC, identifying its own members as the investment committee of WPHIC. Accordingly, it was recommended that the board of directors formally recognize this joint investment committee if the board was to continue to allow the committee to act on its behalf. On May 26, 1995, the board authorized the joint investment committee of Nationwide Mutual Insurance Company and EMPLOYERS INSURANCE OF WAUSAU A Mutual Company "to review and approve investments, to issue executive resolutions, and to otherwise act on behalf of the Corporation in investment decisions, consistent with applicable laws and regulations and existing contractual and other obligations of the Corporation".

Increasing integration of executive management within the Nationwide Insurance Enterprise has resulted in the use of more joint committees. The joint audit committee and joint salary and compensation committee for the Nationwide Insurance Enterprise deliberate and act upon matters which directly concern WPHIC. It is recommended that the board of directors formally recognize any joint committee that it permits to act on its behalf. The board is reminded that the composition of any joint committee must be consistent with s. 611.56 (1), Wis. Stat., unless its role is strictly advisory.

Corporate Records

The examination reports as of December 31, 1989, and as of December 31, 1992, noted that certain aspects of the company's operations were conducted with assistance from

Nationwide Mutual Insurance Company, but that no service agreement existed which clearly and accurately disclosed the specific types of assistance NMIC is providing, and how WPHIC is to reimburse or compensate NMIC for its services. Accordingly, both examination reports recommended that the company adopt a service agreement for this purpose.

Section 611.61(1)(b), Wis. Stat., provides that an insurer may enter into no transaction with an affiliate unless the records of these transactions are kept in a manner that clearly and accurately discloses the nature and details of the transaction. Written service agreements are essential to effectuate compliance with this statute because they provide information critical to an understanding of the purpose and methodology of the accounting transactions reflected in the general ledger and supporting records. This examination indicated that the company has still not entered into a service agreement in compliance with the recommendation of the two prior examination reports. It is again recommended that the company adopt a service agreement with Nationwide Mutual Insurance Company which discloses the services NMIC regularly provides to the company, together with the methods and timing of reimbursement or compensation for these services, pursuant to s. 611.61(1)(b), Wis. Statutes.

The company was incorporated by reference under the terms of an investment advisory agreement between Employers and Nationwide Advisory Services, Inc. (then known as "Nationwide Financial Services, Inc."), effective January 1, 1986. Pursuant to this agreement, Nationwide Advisory Services, Inc., agrees to supply investment management services to Employers and its subsidiaries and affiliates including, but not limited to, development of investment programs, advice, research, statistical data collection, provision of informational reports, and mortgage loan administration. WPHIC's minutes indicate that the board of directors reviews and ratifies the investment activities conducted on behalf of the company on a regular basis.

Within the investment advisory agreement between Employers and Nationwide Advisory Services, Inc., WPHIC and Employers' other downstream subsidiaries were not referenced by name, but simply as subsidiaries of Employers. Accordingly, when WPHIC and its

immediate parent, Employers Life Insurance Company of Wausau, were sold to Nationwide Life Insurance Company effective January 1, 1996, the agreement ceased to apply to these companies. The ongoing servicing relationship between Nationwide Advisory Services, Inc., and WPHIC should be evidenced by a written contract. It is recommended that the company adopt a service agreement with Nationwide Advisory Services, Inc., which discloses the services National Advisory Services, Inc., regularly provides to the company, together with the methods and timing of reimbursement or compensation for these services, pursuant to s. 611.61(1)(b), Wis. Statutes.

Short-term Investments

The company has investment accounts with California Cash Management Company and Nationwide Cash Management Company, both of which are affiliated management companies. These affiliates manage separate portfolios, each consisting of short-duration debt obligations and cash equivalents, for various participating members of the Nationwide Insurance Enterprise.

The principal balances of funds invested with these companies are properly stated and disclosed in the 1996 annual statement. Income derived from these investments is included in Exhibit 2, "Net Investment Income," the summary of operations, and Schedule DA, Part 2, lines 11 and 12, of the annual statement. However, throughout the period under examination, the gross amount of interest received has not been reported in Schedule DA, Part 1, of the annual statement.

The company's data processing system for short-term investments is structured much along the same lines as the annual statement reporting format for bonds. The system allocates income to the various parts of Schedule DA that would exist if its format were like that of Schedule D. While the system may well hold some advantages for the monitoring of transactions on a day-to-day basis, it requires additional effort to convert information to the format of the statutory financial statements. The company's system only includes gross interest received for these investment accounts on Schedule DA, Part 1, with respect to "purchase lots" that are still owned by the company at year-end.

The format of the annual statement provides a reasonable expectation that the gross amount of interest received on an investment fund, as reported on Schedule DA, Part 1, is the gross amount received for the year. Listing the figures for the gross amount received on specific investment accounts on Schedule DA, Part 1, may be analytically useful to people who have occasion to review the annual statement. It is recommended that the company report the gross amount of interest received on short-term investments in accordance with the format of the convention annual statement.

This situation with respect to Schedule DA was noted during the last examination, and a recommendation was made to correct it. During 1995, the company and its affiliates began reporting the short-term investment income on a gross basis on Schedule DA, Part 2. Based on discussions with investment accounting staff, the examiner-in-charge was convinced that company personnel acted to comply with the prior recommendation, as they understood it. Accordingly, this examination has declined to report this as a repeated recommendation.

Accounts Receivable

This account consists of miscellaneous amounts receivable. Examiner review indicated that the balance has been outstanding, and entirely unpaid, since May 1993. This same figure in the amount of \$2,684 has been reported in each annual statement filed with the Commissioner of Insurance since 1993. cursory review of the line item would have identified this balance as one which should have been at least nonadmitted and perhaps written off. Due to the immateriality of the balance, no formal adjustment was deemed necessary for purposes of this examination. Nonetheless, comment on matters of statutory accounting principle are in order in view of the reconciliation difficulties noted in the concurrent examination of EMPLOYERS INSURANCE OF WAUSAU A Mutual Company. It is recommended that the company nonadmit unsecured accounts receivable over 90 days past due in future statutory financial statements. In addition, it is suggested that the company undertake at least a cursory review of all line items at least once a year. Such a review need not coincide with annual statement preparation.

VIII. CONCLUSION

Policyholders' surplus has increased from \$66,238,883 as of year-end 1992, to \$93,570,019 as of year-end 1996. This represents an increase of 41.3% during the period under examination.

The following schedule summarizes the cumulative increases and decreases to surplus from December 31, 1992, when policyholders' surplus was last verified by examination, to December 31, 1996:

Policyholders' surplus, December 31, 1992	\$66,238,883
Net income	21,830,112
Paid-in surplus adjustment	6,000,000
Change in asset valuation reserve	(500,736)
Change in non-admitted assets and related items	<u>1,760</u>
Policyholders' surplus, December 31, 1996	<u>\$93,570,019</u>

Areas of improvement recommended by this examination included, but were not limited to, documenting agreements with affiliates in writing, reporting investment income, and periodic review of annual statement line items.

While the company is a separate legal entity, it has no employees of its own. All of the company's operations are conducted by employees of Wausau Service Corporation and Nationwide Mutual Insurance Company. Therefore, the practices and procedures of these entities and the deficiencies noted in the concurrent examination reports are important to the operating results of the company.

Until the merger with Preferred Health Insurance Company, the focus of WPHIC was on the assumption of life and accident and health insurance risks from affiliated insurers, and the administration of uninsured accident and health plans on behalf of Employers. With the merger, the company became a direct writer of group health plans, including both traditional indemnity and managed care products, but affiliated reinsurance and uninsured plan administration continued as its most significant activities.

A significant change in the company's operations began effective January 1, 1996, when all of the business written or reinsured by the company, including all outstanding loss and loss adjustment reserves, were ceded to Employers Life Insurance Company of Wausau. Employers Life took on WPHIC's former role as a reinsurer of affiliated life and accident and health insurance risks, and as the administrator of accident and health insurance plans for Employers. On a prospective basis, WPHIC is expected to concentrate its activities on providing commercial health insurance products issued in conjunction with other products sold by other companies in its holding company system.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 36 - Management and Control — It is recommended that the board of directors formally recognize any joint committee that it permits to act on its behalf. The board is reminded that the composition of any joint committee must be consistent with s. 611.56 (1), Wis. Stat., unless its role is strictly advisory.
2. Page 37 - Corporate Records — It is again recommended that the company adopt a service agreement with Nationwide Mutual Insurance Company which discloses the services NMIC regularly provides to the company, together with the methods and timing of reimbursement or compensation for these services, pursuant to s. 611.61(1)(b), Wis. Statutes.
3. Page 38 - Corporate Records — It is recommended that the company adopt a service agreement with Nationwide Advisory Services, Inc., which discloses the services National Advisory Services, Inc., regularly provides to the company, together with the methods and timing of reimbursement or compensation for these services, pursuant to s. 611.61(1)(b), Wis. Statutes.
4. Page 39 - Short-term Investments — It is recommended that the company report the gross amount of interest received on short-term investments in accordance with the format of the convention annual statement.
5. Page 39 - Accounts Receivable — It is recommended that the company nonadmit unsecured accounts receivable over 90 days past due in future statutory financial statements. In addition, it is suggested that the company undertake at least a cursory review of all line items at least once a year. Such a review need not coincide with annual statement preparation.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers of the company and employees of Wausau Service Corporation and Nationwide Mutual Insurance Company is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Cruz J. Flores	Senior Insurance Examiner, Data Processing Audit Specialist
Teri M. McClintock	Financial Examiner
Akin Morakinyo	Financial Examiner
Bertram O. Oparaji	Financial Examiner
Eleanor Opprieht	Financial Examiner
Roger A. Peterson	Senior Insurance Examiner, Loss Reserve Audit Specialist
Frederick H. Thornton	Senior Insurance Examiner, Exam Planning & Quality Control Specialist

Respectfully submitted,

Steven J. Junior
Examiner-in-Charge